IN THE

Supreme Court of the United States

OCTOBER TERM, 1962

No. 405

UNITED STATES, *Petitioner*

v.

PIONEER AMERICAN INSURANCE COMPANY, ET AL.,
Respondent

BRIEF OF THE MORTGAGE BANKERS ASSOCIATION OF AMERICA AND THE NATIONAL ASSOCIATION OF MUTUAL SAVINGS BANKS, AMICI CURIAE, IN SUPPORT OF RESPONDENT

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JURISDICTIONAL STATEMENT

This brief is filed, pursuant to Rule 42, with the written consent of Petitioner and Respondent. Such written consents are submitted herewith.

INTEREST OF AMICI CURIAE

The nature of the interest of the amici curiae is as follows:

The Mortgage Bankers Association of America and The National Association of Mutual Savings Banks are trade associations representing, respectively, the

mortgage bankers and the mutual savings banks of the United States.

The Mortgage Bankers Association of America is interested in the disposition of this case because it has among its members all types of institutional investors, including life insurance companies and savings banks. The Association's membership also includes mortgage companies throughout the United States which originate all types of mortgages in large volume and service them for the institutional investors they represent. If the decision below is reversed, a considerable unanticipated financial burden may be imposed upon mortgage companies which are charged under their servicing contracts with the responsibility of protecting the interest of their investors for a fixed amount that cannot be changed. Also, if the decision below is reversed, the opportunities for sales of mortgages by mortgage companies may be greatly reduced.

Mutual savings banks are large investors in mortgages of all types and particularly in home loans guaranteed by the Veterans Administration or insured by the Federal Housing Administration. Such loans have been made in reliance on the long established practice and rule that the holder of a prior recorded mortgage will be permitted to recover the costs of foreclosing the lien which it holds, in the event of default, and that among those recoverable costs will be the amount of attorneys fees incident to such foreclosure proceedings. If the decision below is reversed, many of the loans now held will become subject to a potential jeopardy not contemplated when the loans were made. In the event of substantial economic decline and the consequent increase in defaults, which would undoubtedly be accompanied by similar increase in the number and

volume of liens asserted by the United States, a lender could be forced by a reversal of the decision below to bear an unanticipated share of any deficiency and the not inconsiderable legal costs incident to the foreclosure of its prior recorded mortgage or deed of trust.

The attached brief sets forth arguments which will be relevant in determining whether a reversal of the decision below would tend to frustrate the long series of legislative acts and court decisions which, almost since time immemorial, have protected *all* the interests of the holder of a prior recorded mortgage on real estate. These arguments may not be available to or may not adequately be urged by respondent.

The Mortgage Bankers of America and The National Association of Mutual Savings Banks and their members are greatly interested in obtaining a holding by this Court as to the applicability of earlier decisions relating to federal tax liens to the generally recognized principal that costs of foreclosure, including attorneys' fees, will be recognized in settling accounts in connection with the default of a prior recorded mortgage on real estate so that savings banks and mortgage bankers may reappraise the extent of their prudent participation in the making, recording and ownership of first mortgages on real estate.

THE PERTINENT FACTS

The mortgage (in form a deed of trust) was recorded July 7, 1956, securing a debt subsequently assigned to Pioneer. It provided that the debt secured thereby should be increased, in case of default, by the costs, charges and attorneys fees involved in collection proceedings (R. 13), and that the proceeds of any sale of the property thereunder should be applied *first* to pay the costs and expenses of executing the trust, including such attorneys fees (R. 14).

The mortgagors defaulted in October 1960, and on March 24, 1961, the foreclosure proceedings were filed by Pioneer in the chancery Court of Sebastian County, Arkansas. The United States filed five tax liens against the property, all after the default occurred, the last three being filed after the foreclosure proceeding began. On November 11, 1961, the Chancery Court entered a decree of foreclosure which found the tax liens subordinate to the lien of Pioneer "for all the amounts it secures, including principal of the note and interest thereon; * * * and attorney's fees fixed by the Court" (R. 72-74). The decree also fixed the fee of a court-appointed Receiver (R. 70) and of a Commissioner (R. 45, 47, 51), which were taxed as costs.

The petitioner did not object to the priority given the fees paid the Receiver and the Commissioner, but asserted that the tax liens had priority over the attorney's fee. On appeal to the State Supreme Court, the decree was affirmed.

STATUTES INVOLVED

The provisions of Sections 6321, 6322 and 6323 of the Internal Revenue Code are set forth in the Appendix, *infra*, p. 14.

SUMMARY OF ARGUMENT

1. Section 6323(a) of the Internal Revenue Code makes the federal tax lien invalid as against any of the mortgagee's rights which were secured by the prior recorded mortgage, including all the costs of foreclosure, such as attorneys fees.

2. It would be inequitable to tax respondent and enrich petitioner by the amount of the cost of bringing into existence the fund on which petitioner had established a lien.

ARGUMENT

1. Section 6323(a) of the Internal Revenue Code Makes the Tax Liens Invalid as Against Any of Pioneer's Rights Secured by the Prior Recorded Mortgage

Section 6323(a) states unequivocally that the tax lien provided by sections 6321 and 6322 "shall not be valid as against any mortgagee" (except upon filing in the manner provided). Unless this is construed to mean that the tax lien may not be given priority over the *entire* obligation secured by the mortgage, it is meaningless and impossible of application.

This statutory provision was originally enacted as Public Law No. 451, of the 62nd Congress, approved March 4, 1913, taking the form of an amendment to Section 3186 of the Revised Statutes, and was later embodied in Section 3672 of the Internal Revenue Code of 1939, which became Section 6323(a) of the Internal Revenue Code of 1954. Its purpose was explained in

the report of the Judiciary Committee of the House of Representatives (House Rep. No. 1018, 62nd Cong., 2d sess.), as being to remove the inequity of the prior law, as construed by this Court in *United States* v. *Snyder*, 149 U.S. 210. It was there held that the federal tax lien was valid and binding against a bona fide purchaser or encumbrancer in good faith for value without knowledge or notice of such a lien. The report of the Judiciary Committee concluded by saying:

> "There is no reason why the Government should not occupy the same position with reference to liens on property as does the individual."

Provisions in mortgages which extend the mortgage lien to the expense of enforcement of the mortgagee's rights are and for many years have been commonplace. There is nothing in the statute or its legislative history to indicate that Congress intended that the preference given mortgagees over tax liens would differ in kind and quality from the preference mortgagees have historically enjoyed against other lienors. On the contrary, the Committee report cited made clear that the Government, in this respect, should be placed on the same level as an individual.

Certainly, after this mortgage was recorded, there was notice to all the world, including the Government, that Pioneer's secured lien was not only for unpaid principal and interest on the debt but also for all expenses of foreclosure in the event of default, specifically including attorney's fees. Petitioner here takes the anomalous position that, while the tax claim does not have priority over other costs of foreclosure (such as fees paid to a Receiver and to a Commissioner appointed by the Court) it does have priority over the

fee allowed the attorneys for conducting the foreclosure proceedings.

None of the decisions of this Court on which petitioner relies supports this position, since none of them involved liens of the type covered by section 6323(a). In *United States* v. *New Britain*, 347 U.S. 81, upon which petitioner chiefly relies, the question was one of priority as between Federal and local taxes, and this Court said (p. 88):

> "There is nothing in the language of section 3672* to show that Congress intended antecedent federal tax liens to rank behind *any but the specific categories of interests set out therein*, and the legislative history lends support to this impression." (*Emphasis supplied*)

The *New Britain* opinion cited Mr. Justice Jackson's concurring opinion in *United States* v. *Security Trust & Savings Bank of San Diego*, 340 U.S. 47, where it was held that the asserted lien was not, as claimed, that of a "judgment creditor" under section 3672. Mr. Justice Jackson, after reviewing the legislative history, said (p. 53):

> "My conclusion from this history is that the statute excludes from the provisions of this secret lien those types of interests which it specifically included in the statute and no others."

In short, both the *New Britain* case and the *Security Trust & Savings* case recognized that federal tax liens do rank behind the specific categories of interests set out in section 6323(a), and sustained the tax liens in those cases because the contesting liens were not of the character listed in 6323(a).

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* Now section 6323(a) of the 1954 Code.

Petitioner's construction of section 6323(a) would limit its application to *some* of the rights secured by the mortgage (principal, interest and *some* costs of collection), but not to others. Petitioner singles out the attorney's fees on the sole ground that the *amount* was not established when the federal tax liens "arose".* However, the same thing can be said as to the other foreclosure costs and, indeed, to mortgage interest thereafter accruing, all of which petitioner concedes have priority.

This argument, we submit, distorts the statutory language, by reading words into it which are not there, and ignores the legislative history.

The only decision by this Court involving the status of a mortgage lien which also secured attorney's fees is *Security Mortgage Company* v. *Powers*, 278 U.S. 149, where it was said (p. 155):

> "But the mortgage company does not seek to prove the claim in bankruptcy. It asks to have it allowed *as a part of the principal debt*, which is secured by a lien upon the property sold. * * * *The lien was not inchoate at the time of the adjudication. It had already become perfect when the principal note and the loan deed securing it were given.* Property subject to a lien to secure a liability still contingent at the time of bankruptcy is not discharged from the lien by the adjudication. The *secured obligation* survives; * * *. When by the happening of the event the contingent liability becomes absolute, the lien becomes enforceable, though this occurs after the adjudication." (*Emphasis supplied*)

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* The test under section 6323(a) is not when the liens arose, but when notice was filed.

In *United States* v. *Sampsell* (CA 9), 153 F. 2d 731 (1946), tax liens were subordinated to the payment of attorney's fees under a similar provision of a mortgage, on the ground that "attorney's fees are a part of the secured debt and are entitled to be collected as such."

The same result was reached by the Fourth Circuit in *United States* v. *Seaboard Citizens Nat. Bank*, 206 F. 2d 62 (1953), where the United States sought forfeiture of an automobile it had seized for a violation of the internal revenue laws. The holder of a mortgage on the automobile intervened in the action asking remission of the forfeiture to the extent of its mortgage interest under 18 U.S.C. 3617. The mortgage, and the note secured thereby, provided for payment of an attorney's fee, which was ordered paid to the mortgagee from proceeds of the sale. The United States conceded the validity of the lien as to all except the attorney's fee which the Court had allowed. In rejecting the Government's claim, the Court said (p. 63):

> "Upon the seizure of the automobile by the officers, it was necessary for the bank" (the mortgagee) "to employ counsel to collect its note which was in default. The fees which they earned *were a part of the debt evidenced by the note and secured by the mortgage and there is no reason why they should be treated other than as a part of the debt so secured.*" (*Emphasis supplied*)

and at p. 64:

> "The argument that the government will be burdened by allowing such fees to be included in the lien as to which remission is granted is without foundation. *The government does not pay the fees. They are paid out of the proceeds of the property condemned.* There is no obligation rest-

ing on the government to provide for the remission of any part of the lien on the condemned property; but, if such remission is authorized, as it is, on the theory that an innocent lienholder should not suffer from the forfeiture, *there is no reason why he should suffer the loss represented by attorney's fees where these are expressly covered by his lien.*" (*Emphasis supplied*)

In the following cases, the Court allowed the mortgagee, without comment or objection by the United States, a preference for attorney's fees incurred subsequent to the filing of the federal tax lien:

Smith v. *United States* (U.S.D.C. Hawaii), 113 F. Supp. 702 (1953)
Ormsbee v. *United States* (U.S.D.C. Fla.), 23 F. 2d 926 (1928)

In *Streeter Bros.* v. *Overfelt* (U.S.D.C. Mont.) 202 F. Supp. 143, (1962), from which the Government did not appeal, the facts were on all fours with the facts in the present case. The mortgage provided for payment of costs and attorney's fees. The Government's notices of tax lien were filed after the mortgage was recorded but prior to the foreclosure. The Court nevertheless held that the lien for attorney's fees was prior to the Government's tax lien, saying:

"Here the mortgage expressly provides for the payment of costs and attorney fees. The statutes of Montana also provide that in an action to foreclose a mortgage the court must allow, as a part of the costs, a reasonable attorney fee.

* * * * *

"*Costs and attorney fees*, like interest, *are a part of the mortgage debt itself and are also a necessary expense of enforcing the mortgage lien.* The

> Court of Appeals of the Ninth Circuit has recognized repeatedly the mortgagee's preference with respect to accruing interest. Particularly in view of the fact that the mortgage was in default when the federal tax liens attached, costs and attorney fees should be accorded the same status as interest, even though the exact amount of each may not be ascertained until decree of foreclosure is entered." (p. 146). (*Emphasis supplied*)

The only Federal Court decision which might be considered to the contrary appears to be *United States v. Bond* (CA 4) 279 F. 2d 837 (1960), decided by a divided court. However, it does not appear from the facts in that case that the mortgage contained an explicit provision for attorney's fees on foreclosure. It is also to be noted that that case involved an action by the United States to foreclose its tax liens. Also, in the *Bond* case, the District Court filed a memorandum opinion (not reported) from which it appears that the Government conceded that the mortgage entitled the mortgagee to reimbursement for counsel fees; but denied the validity of its claim on the ground that "counsel was not needed except to put the mortgage before the Court." See Point 2, *infra*.

2. The Petitioner Would be Unjustly Enriched by a Reversal

The property here was subject to several competing liens. Any of the lienholders, including the United States, could have brought enforcement proceedings. If, for example, the first mortgagee had not taken any action, the Government to protect its lien might have found it necessary to reduce its claim to judgment. In order to obtain judgment it would have been necessary for the Government to have instituted foreclosure proceedings. To do this the Government would have had

to use its own attorneys. It would thus have had to assume the costs of such attorneys one way or the other, either in terms of paying the salaries of its own lawyers or of paying a fee to special counsel hired for the purpose. If this course had been pursued, the Government would have been compelled to recognize the right of the first mortgagee to the entire amount of the outstanding principal and interest on the mortgage *without any reductions of any sort*. But the effect of the Government's position in the *Pioneer* case is that, since it was the *mortgagee* which initiated legal action, the Government should not have to bear any part of the legal costs incident to such action even though it is this action which in a very real sense "produced" the funds from which the Government will be paid.

Having failed to take action to enforce its lien, and thus having forced the mortgagee to take action, the Government ought not to be in any better position than it would have been if it had sought to protect itself by initiating foreclosure proceedings through its own counsel and at its own expense. Thus, whatever it has cost the mortgagee to produce the funds which will not only pay off the the outstanding principal and interest but will be used to pay the Government's claim in part, such costs ought to be deducted from the proceeds before the Government is allowed to assert its rights against other claimants. Any other decision would give the Government a "super priority" and unduly penalize the mortgagee for having taken action from which the Government received a benefit.

The argument in the Government's brief that the services of the mortgagee's attorneys did not "create a fund in the sense that attorneys do when they successfully prosecute and recover claims for damages . . ." (p. 18)

does not seem to be pertinent. Whether or not the mortgagee's attorney's efforts "created a fund", they were a necessary condition to securing possession of the fund from which the Government will benefit.

As the Court said in *United States* v. *Bond*, *supra*, in distinguishing its own decision in *United States* v. *Seaboard Citizens National Bank*, *supra*, (p. 847):

> "In the *Seaboard* case, any amount received by the United States from sale of seized property was unanticipated revenue, a windfall, not to be credited as a payment on a fixed indebtedness."

CONCLUSION

The judgment of the Supreme Court of Arkansas should be affirmed.

Respectfully submitted,

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I, H. Cecil Kilpatrick, of counsel for *amici curiae* hereinbefore named, hereby certify that a copy of the foregoing brief was served on the Solicitor General, Department of Justice, Washington 25, D. C., by delivery by his office on March 7, 1963, and that a copy was served on counsel for respondent, Owen C. Pearce, Esq., 107 Professional Life Building, Fort Smith, Arkansas, by depositing the same in the United States mail with air mail postage prepaid on the same date.

H. CECIL KILPATRICK

APPENDIX

Internal Revenue Code of 1954:

Sec. 6321. Lien for Taxes.

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.
(26 U.S.C., 1958 ed., Sec. 6321.)

Sec. 6322. Period of Lien.

Unless another date is specifically fixed by law, the lien imposed by section 6321 shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed is satisfied or becomes unenforceable by reason of lapse of time.
(26 U.S.C., 1958 ed., Sec. 6322.)

Sec. 6323. Validity Against Mortgagees, Pledgees, Purchasers, and Judgment Creditors.

(a) *Invalidity of Lien Without Notice.*—Except as otherwise provided in subsection (c), the lien imposed by section 6321 shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the Secretary or his delegate—

(1) *Under state or territorial laws.*—In the office designated by the law of the State or Territory in which the property subject to the lien is situated, whenever the State or Territory has by law designated an office within the State or Territory for the filing of such notice; or

(2) *With clerk of District Court.*—In the office of the clerk of the United States district court for the judicial district in which the property subject to the lien is situated, whenever the State or Territory has not by law designated an office within the State or Territory for the filing of such notice; * * *

* * * * *

(26 U.S.C., 1958 ed., Sec. 6323.)